

Using CRA-Qualified Community Development Activities to Reach More Small Businesses

By John Olson

Not all small businesses are candidates for conventional financing from financial institutions. The business may be too small, too new, or the business owner may require additional technical assistance to be ready for financing. While these businesses may fall outside the financial institution's lending guidelines, financing for these businesses is a critical credit need in many communities. Under the CRA, financial institutions are rewarded for community development activities that help these businesses get the financing or education they need.

For small institutions, these lending-related community development activities are evaluated only at the institution's discretion. For intermediate small institutions, these activities are evaluated under the Intermediate Small Bank Community Development Test. For large institutions, these activities will be evaluated under one of the three tests – Lending, Service, or Investment Tests – depending on the nature of the activity. Regardless of how the activity is evaluated, supporting small businesses through qualified community development programs and products can be an important part of a comprehensive response to a critical community credit need.

Partner With a Community Based Lender

One key way for a financial institution to expand its reach to small businesses is to partner with a CDFI or other community-based lender that has a focus on small business lending. A range of activities can be considered under the CRA. Providing a line of credit or other lending facility to such an organization can be considered under the Lending Test. Possible community development services include serving on the organization's board of directors, providing technical assistance to the organization, or sitting on a loan review committee. Making an equity investment (including equity equivalent, or EQ2, investments) in, or making a qualified contribution to, a small business CDFI can be considered under the Investment Test.

Partner With a Technical Assistance Provider

One of the most important ways an unbankable or near bankable business can get ready for bank financing – perhaps

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the most important way – is to take advantage of the educational and training resources provided by small business technical assistance organizations. These services may be offered by a nonprofit, an SBDC, or a community college, and include everything from assistance with business plan preparation to business incubation services. A range of community development possibilities exist for these community partners as well. Providing a facilities loan for a business incubator can be considered under the lending test. Community development service options include serving on a board or providing technical assistance to the organization or to the organization's clients. A qualifying contribution to one of these organizations would be considered under the Investment Test.

The Exam

CRA examiners don't expect that the bank or thrift they are examining will be able to respond to every community credit need on its own. Examiners will, however, be looking for ways that the institution has used its community development partners to address these needs. The successful CRA officer will demonstrate that: 1) the bank understands the small business needs in the assessment area, how those needs are being met, and whether there are any unmet needs; 2) the bank has used its own products and resources to respond to these needs within the bounds of safety and soundness; and 3) the bank has partnered with community-based organizations and other entities that can help the bank expand its reach to the small businesses in its community. 